



Hawaii State Legislature

January 27, 2009

Mr. Kurt Kawafuchi
Director, Department of Taxation
830 Punchbowl Street
Honolulu, HI 96813

Dear Mr. Kawafuchi:

Re: Corrections to Department of Taxation Testimony and to Report entitled
"The Impact of the High Technology Business Investment Tax Credit on
Hawaii's Economy for Calendar Year 2007" (December 2008)

Thank you for participating in the January 20th joint EDT-EBM Committees' briefing on the background leading to adoption of Acts 221-215.

We appreciated your department's comments, and submit the following questions to address concerns raised by committee members and testifiers regarding several conclusions of the December 2008 report.

Because the purpose of Act 206, SLH 2006 was to generate accurate information on the usage of Acts 221-215, and to analyze whether Act 221 investments are achieving the purposes for which they had been adopted, we are concerned that the department's December 2008 report draws conclusions regarding all Act 221 beneficiaries based upon data collected from 2007 tax filers (177 tax filers rather than all 333 QHTB filers from earlier years).

As such, we would appreciate your department's correcting information in the December 2008 report to accurately report on the following comparisons:

1. **Indicative Acquisition Cost per position:** the December 2008 report identifies "an indicative acquisition cost of approximately \$535,000."
 - a. Please explain how this number was computed. Was the \$535,000 obtained by using \$1.2 billion invested in 333 QHTBs during 2000-2007 (December 2008 report, page 5) and dividing the investment number by 2,245 employee jobs reported by 177 QHTBs in 2007 alone?
 - b. In your testimony, you stated that 2,118 independent contractor jobs that were paid a total of \$94 million (December 2008 report, page 10) were not included in the calculation of the acquisition costs per position. We believe that all types of jobs – whether full-time or part-time positions within individual Act 221 businesses, or independent contractors, consultants and others whose services contribute to the growth and expansion of Act 221 businesses should be counted. As such, if the contributions of these independent contractors were included in the calculation of the

‘indicative acquisition cost per position,’ what would the Department’s cost estimate per position be?

- c. Why was \$1.2 billion used as the cost number to calculate job creation in the Department’s report when the report also stated that the total estimated costs of the investment credit were \$657.5 million (December 2008 report, page 17)?
- d. Please state whether the Department divided eight years of costs (2000-2007) by the number of permanent or part-time employee jobs reported by the 177 Act 221 filers in 2007. If that is true, then please provide a calculation reflecting the 2007 costs and 2007 job creation reported by 177 Act 221 filers for the single year to offer an apples-to-apples comparison.

If total costs for Act 221 filers (2000-2007) cannot be compared against the total number of permanent or part-time employees, independent contractors and consultants employed by all Act 221 companies filing between 2000-2007, please identify the type of information needed from Act 221 filers who did not file a return in 2007 (e.g., based on new Act 221 investments).

- e. In adopting Act 206, SLH 2006, the Legislature was mindful of the fact that tech start-ups are rarely profitable, nor do they employ large numbers of staff, during their early years when venture financing is necessary.

As such, the type of data that is valuable to the Legislature in evaluating the costs and benefits of Act 221 is a comparison of total investments made by Hawaii and out-of-state investors, against total expenditures made by Act 221 businesses in Hawaii. Such a comparison would be similar to the type of comparisons made when comparing expenditures for construction (e.g., large-scale public works, public facilities, etc.) against the numbers of seasonal jobs and expenditures made within the local economy.

What additional information can Department of Taxation provide to reflect the comparison of total investments made by Hawaii/non-Hawaii investors in the 177 Act 221 filers, against the numbers of jobs and expenditures made within the local economy for 2007?

- 2. **“Indicative Acquisition Cost for each successful QHTB”:** December 2008 report, page 17.

- a. The Department’s December 2008 report concludes, “the indicative State acquisition cost for each successful QHTB who received funds between July 1, 2007 and December 31, 2007 is \$31.6 million.” Please provide an explanation of how the \$31.6 million was computed, and the assumptions that were used in arriving at the final calculation.
- b. Was the \$31.6 million figure obtained by dividing the \$1.2 billion invested in 333 Act 221 filers between 2000-2007 (December 2008 report, page 5) by 38 Act 221 filers

who received investments between July 1, 2007-December 31, 2007 while they were already profitable (December 2008 report, page 17)?

- c. What is the Department's rationale for limiting the definition of "successful QHTBs" only to those QHTBs that were profitable and who also received investments during the period July 1, 2007 through December 31, 2007, while attributing to those QHTBs a cost estimate equal to all investments made by 333 QHTBs over an 8-year period?
 - d. What is the Department's rationale for identifying only profitable QHTBs as being "successful" when most tech companies need investment capital precisely because they are not profitable during their start-up phases (e.g., often because of the high costs of research)? Recent research states that venture-backed companies who successfully achieved a public offering in 2008 required an average of 8.3 years to achieve that level of profitability.
3. **Excluded data from September 2008 report:** Additional information on the benefits of Act 221 published in the September 2008 report (e.g., \$1.4 billion spent in Hawaii by QHTBs between 2002-2007) was not included in the December 2008 report. What was the basis for excluding this information from the December 2008 report? Please identify and list any other Act 221 information from the September 2008 report that was not included in the December 2008 report, and provide the rationale for the exclusion.
4. **Number of QHTBs Reporting (Partial) Benefits on Form N-317: 333 vs. 177:** Between 2002-2007, 333 QHTBs filed Form N-317, while 177 QHTBs filed Form N-317 in 2007 alone. Pursuant to Act 206, SLH 2006, Form N-317 was significantly enhanced in 2007 to ask more questions to measure the benefits of the Act 221 investment credit.

Act 206 statutorily required QHTBs who received new investments on or before July 1, 2007 to file the enhanced Form N-317 (although some additional QHTBs voluntarily filed Form N-317 in 2007. Prior to 2007, the Department required QHTBs to file Form N-317 only in the year that they received new investment (and not over the entire 5 year period).

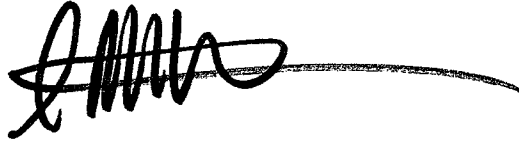
However, since Act 206, SLH 2006 sought to compile data regarding all Act 221 investments, costs and benefits, the data being analyzed for 2007 results in an under-reporting of the benefits of Act 221, while the full costs of the tax credit have been reported on a separate Form N-318. Please provide recommendations for amendments to Act 206, SLH 2006 that would require all Act 221 filers (from 2002-present) to file an N-317 form each year irrespective of whether new Act 221 investments were received. The proposed change will allow Department of Taxation to collect accurate information from filers of N-317 and N-318 forms.

Your department's responses to the above questions would be greatly appreciated by **Monday, February 2, 2009**. Please call us at 586-6890 or at 586-6160 if you have questions on the above request.

Sincerely,



Senator Carol Fukunaga
Senate Committee on Economic
Development and Taxation



Representative Angus McKelvey
House Committee on Economic Revitalization,
Business and Military Affairs

cc: Ms. Linda Smith, Senior Advisor – Office of the Governor
Senator Colleen Hanabusa, President of the Senate
Representative Calvin Say, Speaker of the House